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SUBJECT: ARROYO CELEBRATES JULY 4TH, BUT SUPREME COURT  
DECISION SPARKS MORE TURMOIL

REF: A. MANILA 3046

- [1](#)B. MANILA 2993
- [1](#)C. MANILA 2887
- [1](#)D. MANILA 2840
- [1](#)E. MANILA 2167

Classified By: Political Officer Andrew McClearn for  
reasons 1.4 (b) and (d).

[1](#)1. (C) Summary: President Arroyo attended Mission's July 4 celebration and also hosted an anti-trafficking event at Malacanang attended by Charge on July 2. At the July 4 event, Charge publicly hailed close U.S.-Philippine ties and underscored the importance of strengthening democratic institutions. Amid Arroyo's attempts to show that she is focused on governing despite continued political tensions, the Supreme Court's surprise July 1 decision to place a Temporary Restraining Order (TRO) on the Expanded VAT law has taken a serious toll on the peso, the stock market, and investor confidence. Contacts believe that the President worked in backchannel fashion to secure the TRO, despite Malacanang claims that it opposed the decision. The opposition plans to ramp up its efforts to pressure Arroyo to quit or face impeachment, and the left is planning more rallies. The signs are that political turmoil will continue, with the Supreme Court's TRO handing economic reform efforts a serious setback. End Summary.

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Celebrating July 4; Wrapping Herself in "Old Glory"  
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[1](#)2. (U) In a first since she came to power in 2001, President Arroyo attended Mission's July 4 celebration. Vice President Noli de Castro and a host of other dignitaries, including top cabinet and military officials also attended the event, which was held at the Chancery. In his toast, Charge stated, in part: "Sometimes we as a people decide, through the democratic process, to fix what we perceive is wrong with our country. Other times we discern that what is best for our country is to accept imperfection and mistakes as inevitable and tolerable. Always keeping in mind that what is most important is strengthening the democratic institutions that are our only true safeguard against both tyranny and anarchy." (Para 15 contains additional portions of Charge's remarks, which are also on the Embassy's website.)

[1](#)3. (C) In response, Foreign Affairs Secretary Albert Romulo offered a brief toast on behalf of the GRP. Arroyo made no formal remarks. Her appearance received significant press coverage in both broadcast and print media. A smiling Arroyo was apparently somewhat caught off guard by Charge's brief comment regarding the "snap" election of 1986 (see Para 15), and subsequently instructed Admiral Ernesto De Leon, the Chief of the Philippine Navy, to inquire as to whether there was any significance to the reference. (DATT dismissed the suggestion out of hand, and reiterated that Mission supports transparency, accountability, and the rule of law.) Palace Spokesman Ignacio Bunye earlier on July 4 had reiterated the Palace's view that the President would continue in office, stating: "Our President believes there is no basis for her resignation because she has not committed any illegal act."

[1](#)4. (U) President Arroyo also used a July 2 anti-trafficking in persons event at Malacanang to reaffirm her willingness to cooperate with the U.S. on a wide range of human rights and economic initiatives. A feisty Arroyo also publicly rebutted her critics, brushing off charges that she cheated in the 2004 elections and lambasting the opposition, stating: "If my opponents feel that the best thing for the nation is to tear it down, so be it on their part." Arroyo said she would "turn the other cheek" to her opponents and would not be deterred from carrying out "the people's business." Charge delivered remarks that urged the GRP to follow through on its efforts to secure convictions under the Philippines' 2003

## Anti-Trafficking Law.

15. (U) In other Malacanang-related news, First Gentleman Jose Miguel "Mike" Arroyo had his lawyers object to a subpoena issued last week meant to force his testimony at the high profile corruption trial against former president Joseph Estrada. On July 4, Mike Arroyo's lawyers appeared before the Sandiganbayan court, which gave them ten days to file a motion to dismiss the June 30 subpoena. According to media reports, Mike Arroyo was scheduled to depart Manila July 5 for the U.S. together with son Congressman Juan Miguel "Mikey" Arroyo.

## ----- Surprise Supreme Court Decision -----

16. (U) Amid Arroyo's attempts to show that she is focused on governing despite continued political tensions, the Supreme Court's unexpected July 1 decision to place a TRO on the Expanded Value Added Tax (E-VAT) law has taken a serious toll on the peso, the stock market, and investor confidence. The Court voted 13-2 in favor of the TRO. Chief Justice Davide and Justice Puno were the only dissenting votes. The Supreme Court scheduled a hearing on July 26 on the substance of the case.

17. (U) The E-VAT law is the centerpiece of a hard-fought package of fiscal reform legislation recently won by Arroyo and her allies in Congress. The provisions that went into effect lifted the exemptions enjoyed by the petroleum and electric sectors, among others, and were expected to increase government revenues by PHP4-PHP5 billion (USD 70-90 million) per month. The law also would allow the President to increase the VAT rate from 10 to 12 percent in January 2006 if the budget deficit and VAT collections exceed 1.5 percent and 2.8 percent, respectively (ref E).

18. (U) Two groups had filed motions requesting the TRO only on June 30; one group was led by the Association of Philippine Petroleum Dealers and the other group consisted of opposition lawmakers. (Note: Two other groups of educators and opposition lawmakers had filed a petition before the Supreme Court to invalidate the law shortly after it was signed in May 2004, but the Court declined those petitions.) Opponents of the E-VAT argued that the portion of the law removing the "no pass through" provision for the petroleum and electricity sectors was invalid because the provision was inserted in the bicameral conference committee by deleting a provision present in both the Senate and House versions without proper authority. They also challenged the law on the grounds that giving the President the discretion to increase the VAT rate next year unconstitutionally delegates taxing authority from the Congress to the Executive. The petroleum dealers also specifically opposed a provision in the amended E-VAT law that limits the quarterly input VAT credits to 70 percent of output VAT credits.

19. (S) Finance Secretary Cesar Purisima told Acting Econ/C he was caught off-guard by the Court's move. He said he was convinced that the TRO was "arranged" by Malacanang because Arroyo feared that its implementation would lead to street protests. Other sources, including Arroyo ally Congressman Jesli Lapus, Chair of the House Ways and Means Committee, separately told A/DCM and other emboffs that Arroyo was behind the TRO. He said Malacanang had asked for Congressional help two weeks ago to delay implementation, but Lapus and others said it could not be done. Supreme Court Program Management Director Evelyn Dum Dum also confirmed to poloff July 2 that the Palace had pressured Justices to agree to the TRO. Purisima described the decision as "devastating," saying that delays in the E-VAT's implementation would derail if not endanger the country's efforts to put its fiscal house in order.

## ----- Peso, Market Hit the Skids -----

10. (SBU) The TRO added to the uncertainties in financial markets already made jittery by the ongoing political tensions. The local currency closed at PhP 56.09 on July 4, the peso's weakest closing rate since January 11. The Philippine Stock Price Index (Phisix) declined by 4.2 percent on July 4 to 1,815.67, posting one of the steepest one-day losses since the 1997 Asian financial crisis and edging down to its weakest closing level since late December 2004. In morning trading on July 5, the Peso opened weaker at PhP 56.15/\$1 and ranged from PhP 56.06 to PhP 56.19 during morning interbank trades. The Phisix closed July 5 up slightly (1817.02) on bargain hunting for blue-chip stocks. Securities dealers demanded significantly higher yields during the GRP's July 4 primary-market Treasury bill auction as a result of resurgent concerns over fiscal stability, combined with higher political risk premiums, prompting the GRP to reject all tenders. Foreign investors also reportedly

sold off Philippine sovereign bonds at somewhat higher yields than in previous days.

11. (SBU) Credit rating agencies expressed concern over the TRO but have adopted a wait-and-see attitude for now, noting that external liquidity and international reserve levels remain comfortable. They warned, however, that substantial delays in implementing the amended E-VAT law or its abandonment would see credit rating outlooks slide from "stable" to "negative" or, even worse, could trigger downgrades in the ratings themselves. GRP foreign bond issues are already rated two to three levels below investment grade, and a further deterioration would exacerbate the already substantial spreads the GRP is paying on its foreign-denominated bond issues. Although the latest estimates on net foreign portfolio investments from January to the third week of June showed USD 1.9 billion in net inflows -- nearly four times 2004's full-year surplus -- traders and analysts noted that the continued combination of both political and economic setbacks is increasingly eroding investor confidence.

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Opposition Plans to Ramp Up Pressure  
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12. (C) The opposition plans to ramp up its own efforts to pressure Arroyo to quit or face impeachment. Opposition Senator Panfilo "Ping" Lacson told Acting Pol/C on July 1 that he planned to urge that the hearings currently underway in the House and Senate continue "until the whole truth is known." Renato de Villa, an opposition figure and former defense secretary under Fidel Ramos, told emboffs in a July 1 meeting that "among the average Filipino, it's already indisputable that Arroyo is guilty, that she won a rigged election." De Villa and opposition member Louie Sison (political adviser for Brother Eddie Villanueva) also told emboffs that there are opposition plans to release "damaging material" against Arroyo in coming days, although neither provided additional information. In a blow to Arroyo, the Brothers of De La Salle, a Roman Catholic order who teach and manage De La Salle University and other schools, issued a statement on July 2 calling on Arroyo "to voluntarily relinquish power so that the constitutional process of succession may proceed." The University of the Philippines Law School, and several schools affiliated with Ateneo University, made similar public pronouncements.

13. (C) Representative Teodoro "Teddy" Casino of the Bayan Muna party told emboffs on July 4 that Bayan Muna and other leftist groups were planning additional public protest rallies against Arroyo. Casino said the anti-Arroyo effort was "beginning to take a life of its own" among some civil society groups that had previously supported Arroyo. Casino praised the Supreme Court for issuing the TRO on July 1, arguing that it was "good news" for the poor, who would have been hurt by the higher prices. The National Democratic Front (NDF) -- an umbrella group with close links to the Communist Party of the Philippines and the New People's Army (CPP/NPA) -- issued a statement on July 4 demanding Arroyo's immediate removal from office as a precondition for resumption of the stalled GRP-NDF peace talks. From the Netherlands, Jose Maria Sison, the exiled leader of the CPP/NPA, was quoted as stating: "So long as it stays in power, the Arroyo regime will continue to prevent the resumption of the formal talks."

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Comment  
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14. (S) The signs are that political turmoil will continue, with fallout now appearing on the economic front as well. The Supreme Court TRO has given a black eye to economic reform efforts. Arroyo worked extremely hard to push through the E-VAT law, and its passage had been a significant victory for her efforts to narrow the Philippines' budget deficit -- or so it was thought. The reports that Arroyo actually supported the TRO -- which dealt a solid blow to her own reform efforts -- indicate strongly that her mindset is a defensive, reactive one, and it displays a worrisome but successful effort to interfere with the supposedly independent judiciary at the highest levels. It is clear the President decided against the advice of her chief economic advisers to sacrifice the E-VAT law -- at least until the end of July -- in the interest of trying to buy political peace, especially from leftist elements. If that is the case, there is little sign that it is working: the opposition -- including the left -- gives every indication of wanting to up the ante, and, by doing so, increase the pressure on her to step down. End Comment.

15. (U) A slightly abridged version of Charge's July 4 remarks follows:

"Over the past century, and even this past year, the relationship between our two countries has had its ups and

downs. But like all genuine and mature friendships, as we work through our disagreements, we find ourselves stronger allies. Sometimes in conflict, sometimes in anger, but most times with understanding and mutual admiration, we have grown together. I hope that after my departure (or maybe because of it?) the relationship between our two countries will continue to deepen.

Independence Day is a special day for all Americans, but especially for those of us serving overseas. As Americans in the Philippines we can celebrate in a country that also cherishes the democratic values upon which our own nation was founded.

In the Declaration of Independence, Jefferson speaks of mankind's inalienable rights as "life, liberty, and the pursuit of happiness." I always liked it that only the pursuit of happiness is guaranteed, not happiness itself. It is ultimately our choices as a people that decide, that determine our fate. And, of course, wherever people are involved so is imperfection. This puts a heavy burden on all of us to weigh carefully what is and is not the best course for our countries. Sometimes we as a people decide, through the democratic process, to fix what we perceive is wrong with our country. Other times we discern that what is best for our country is to accept imperfection and mistakes as inevitable and tolerable. Always keeping in mind that what is most important is strengthening the democratic institutions that are our only true safeguard against both tyranny and anarchy.

I will end with a story that unfortunately some of you have already heard before and will now be bored having to hear again. This story was told to me right after the "snap" election of 1986, but before Marcos was actually overthrown. It is a story that strikes a chord with me even now after 19 years. Sometime in mid-February 1986, I met with a close Filipino friend of mine for coffee, but when I sat down it was clear he was very upset. I asked him what was wrong, and he angrily explained that one of his own best friends had decided to leave the Philippines to visit the United States. My friend had asked him, "how can you leave your country now, when we are fighting against Marcos? We must all stay here and fight for freedom and against corruption." His friend replied, laughingly, "Oh come on, you take this all too seriously. I'll be back after things quiet down here. Right now I just want to relax and go visit the Land of the Free and the Home of the Brave." Infuriated, my friend answered: "You may be going to visit the Land of the Free,, but you are leaving the Home of the Brave.,8 And that is the way I always think of the Filipino people, even after 19 years -- as the bravest of people. So, let's acknowledge this remarkable people.

Family and friends, please join me in toasting the health and happiness of the President of the Republic, Her Excellency Gloria Macapagal-Arroyo, and to the brave Filipino people: May the preservation of democracy and your passion for justice continue to be the cornerstone and safeguard of your pursuit of happiness. Mabuhay!"

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